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No. 383

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GEORGE B. CLIFFORD, JR.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

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OPINION BELOW

The opinion of the United States Board of Tax Appeals (R. 7) is unreported. The opinion of the Circuit Court of Appeals (R. 29) is reported in 105 F. (2d) 586.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 24, 1939 (R. 35). The petition for a writ of certiorari was filed September 13, 1939, and was granted November 6, 1939. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer in 1934 declared himself trustee of certain property to pay the net income therefrom to his wife or to hold or accumulate it in his discretion, the trust to terminate at the expiration of five years or upon the earlier death of the taxpayer or his wife. Upon the termination of the trust, the corpus was to be restored to the grantor or his estate but any undistributed net income was to be treated as the property of the wife. The question is whether the net income of the trust for 1934 was properly included in the taxpayer's gross income.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations are printed in the Appendix, *infra*, pp. 30-38.

STATEMENT

The facts as stipulated (R. 21-27) and as found by the Board of Tax Appeals (R. 7-10) may be summarized as follows:

On June 20, 1934, respondent, a resident of Minnesota, declared himself trustee of certain securities which he owned (R. 7). The trust was to terminate upon the expiration of five years or upon the earlier death of respondent or his wife. Upon termination of the trust the corpus was to be "deemed and treated as property owned absolutely by" the grantor (R. 8).

The declaration of trust provided that all net income from the trust estate received during the continuance of the trust should be held for the benefit of respond-

ent's wife,[1] but respondent, as trustee, retained the right to distribute to his wife, quarterly or at such other times as he should deem convenient during any calendar year, the whole or such part of the net income as he in his absolute discretion should determine (R. 7). Any undistributed net income and any proceeds from the investment of any undistributed income remaining at the termination of the trust was to be treated as property owned by the wife (R. 8).

Respondent retained plenary control over the corpus of the trust, including the power to sell, exchange, mortgage, or pledge any of the property upon such terms and conditions and for such consideration as he might deem fitting; to appoint proxies and exercise voting rights; to make investments without limitation of any laws pertaining to the investment of trust funds; to settle any claims; and to hold any trust property in the names of other persons, or in his own name as an individual (R. 8). He exonerated himself from any liability as trustee except for "wilful and deliberate" misconduct (R. 8). And, except as provided above, no title in or to the trust estate or any income therefrom was to vest in his wife; neither the principal nor any undistributed income was to be chargeable ~~to~~ for her debts; and she was to have no power to encumber

[1] However, the trust instrument provided that (R. 8):
"5. Extraordinary cash dividends, any dividends paid in stock or the proceeds received from sale of any subscription rights not exercised, or any enhancement, realized or not, in the value of securities shall be considered and treated as principal and not income."

or dispose of any interest in the trust estate or any income therefrom prior to actual payment or delivery to her (R. 8–9).

Since the creation of the trust, respondent has maintained a separate bank account as trustee in which he has deposited income and cash of the trust. He has paid the net income of the trust to his wife by drawing checks against this account to her order. The larger items of income have generally been paid over to the wife soon after their receipt, while small items have been permitted to accumulate for short periods in the account before payment to the beneficiary. Respondent's wife deposited the income which she received from the trust in her own bank account, intermingling it with her other income and keeping no separate record of its use. Respondent has never withdrawn or used any part of the principal or income of the trust for his own purposes (R. 9–10).

The net income of the trust for the year 1934 was $10,111.23, which included $1,160.96 capital gain (R. 11). The capital gain was reported as income taxable to the trust; the remainder of the net income of the trust was reported as taxable income of the wife. Respondent did not report any of the trust income in his own return (R. 10).

The Commissioner determined a deficiency in respondent's return by adding the trust income to respondent's personal income. The Board of Tax Appeals sustained the Commissioner's action (R. 11–12), but the court below reversed (R. 35).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the income involved was not taxable to the respondent under Section 22 (a) of the Revenue Act of 1934.

(2) In holding that the income involved was not taxable to the respondent under Section 166 of the Revenue Act of 1934.

(3) In holding invalid Article 166–1 of Treasury Regulations 86 as applied to the facts of this case.

(4) In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

Respondent is taxable on the trust income here involved both under Section 22 (a) and Section 166 of the Revenue Act of 1934. Section 22 (a) defines in comprehensive terms the income which the taxpayer must report, and this Court has frequently noted that it expresses the intent of Congress to use its power to the full extent.

The statutory language is refined by the Treasury Regulations which make it plain that the income in question is taxable to the respondent. The relevant statutory provisions have been reenacted by Congress, without change, three times since the first promulgation of the regulation. Since the regulation cannot be said to be clearly in conflict with the statute, the repeated reenactment of the statute compels the conclusion that Congress has adopted the administrative construction.

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It is clear that in the case of some short-term trusts, the grantor retains the substantial equivalent of ownership. *Du Pont* v. *Commissioner,* 289 U. S. 685, 688–689. For example, in the case of a trust created for a month or from day to day the trust income would be taxable to the grantor on the theory that he was in substance the owner of the trust property and the income from the property was therefore *his* income within the meaning of Section 22 (a). There is nothing, then, in the use of the irrevocable trust device which necessarily relieves the grantor of the trust from being taxed on the trust income; the question is simply where the line should be drawn between those irrevocable trusts which deprive the grantor of command over the property and those which leave in him the practical equivalent of ownership. This question is one peculiarly for the judgment of the Treasury Department, which is charged with the administration of the tax law. The judgment of that Department, as embodied in its regulations, cannot be said to be arbitrary and should therefore be given effect.

The realistic nature of the regulations is well illustrated by the present record. The transfer made by the taxpayer did not in any real sense change his economic position. Analysis of the deed of trust shows that he kept plenary control over the corpus of the trust and had substantial rights in the distribution of the income from the trust property, the only restriction being that at the termination of the trust all income not paid over to the beneficiary was to be "deemed and treated" as her property. The practical effect of the transaction

was not the transfer of any rights in the property from the respondent to his wife but merely an advance commitment by the respondent as to the manner in which he would apply future income from the property.

Since respondent retained full control of the securities he conveyed to himself as trustee, he can escape taxation on the income only if he has acquired immunity because he holds legal title as trustee rather than as an individual, or because he has declared in advance that the income is to be that of his wife. The fact that he holds legal title as trustee does not afford such immunity because, as this Court has frequently announced, the reach of the taxing acts is to be determined by the practical substance of transactions rather than by the technical refinements of title. And the fact that respondent declared in advance that the income from the property should be that of his wife is similarly unavailing, since the decisions of this Court foreclose any contention that tax liability can be escaped by the assignment of future income. *Lucas* v. *Earl,* 281 U. S. 111; *Burnet* v. *Leininger,* 285 U. S. 136.

Moreover, the trust income was taxable to respondent under Section 166 of the Revenue Act of 1934, which provides that where a grantor has at any time the power to revest title to any part of the corpus of a trust in himself, the income from such part shall be included in computing his net income. The grantor's rights in the present case were no less than he would have had by creating a trust to last for a longer period but reserving a complete right of revocation at the end of five years. In either event the statute requires the income to be taxed to the grantor.

The decision of the court below furnishes taxpayers precisely the type of loophole which Congress has been assiduous in attempting to prevent. It permits the avoidance of surtaxes by a device which, to the average man, means a mere change of bookkeeping methods rather than a substantive alteration of his financial status. Congress clearly did not intend so to exalt form over substance.

There can be no real question as to the power of Congress to tax to the grantor the income of a short-term trust such as that here involved. This Court has frequently held that tax liability may rest upon the enjoyment by the taxpayer of rights in property so substantial and complete as to make it reasonable and just to deal with him as if he were the owner. That the grantor of a short-term trust has such substantial attributes of ownership as to bring him within this rule was decided in *Du Pont* v. *Commissioner,* 289 U. S. 685. Furthermore, taxation of the trust income to the respondent is within the power of Congress to prevent facile escape from the surtaxes which it has prescribed. *Helvering* v. *City Bank Co.,* 296 U. S. 85.

ARGUMENT

The respondent, we urge, is taxable on the trust income paid to his wife under the provisions of both Section 22 (a) and Section 166 of the Revenue Act of 1934. Section 166 merely defines with particularity instances in which the grantor of the trust is regarded as in substance the owner of the corpus and therefore as properly taxable on the trust income as *his* income within the broad definition of income contained in

Section 22 (a). Regulations 86, Article 166–1 (b), *infra*, pp. 32, 33. Section 22 (a) is the basic provision and consequently, even if the trust here involved does not fall within the terms of Section 166, income from the trust may none the less be taxable to the grantor under Section 22 (a) if, as we contend, the grantor is properly to be regarded as remaining in substance the owner of the corpus. We shall first discuss the broader question and, second, the scope of Section 166.

I

RESPONDENT WAS IN SUBSTANCE THE OWNER OF THE TRUST PROPERTY AND THE TRUST INCOME WAS THEREFORE PROPERLY TAXABLE TO HIM UNDER SECTION 22 (A) OF THE REVENUE ACT OF 1934

1. Section 22 (a) defines, in broad and comprehensive terms, the income which the taxpayer must report as his gross income. That income includes "gains, profits, and income * * * growing out of the ownership or use of or interest in such property" or derived "from interest, rent, dividends, securities * * * or gains or profits and income derived from any source whatever."

The respondent declared himself trustee of securities which he owned; during the five-year trust period their income was to be paid to his wife as beneficiary. The securities were to revert to the absolute ownership of respondent at the termination of the trust; as trustee he had full powers of management and control of the securities. There is no occasion minutely to examine the particular words of Section 22 (a). This Court has

frequently noted that this section shows the intent of Congress "to use its power to the full extent." *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *Irwin* v. *Gavit*, 268 U. S. 161; *Helvering* v. *Stockholms Bank*, 293 U. S. 84, 89; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 93; *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 223. As we show at a later point (*infra*, pp. 28–29), there is no real question of the constitutional power of Congress to tax respondent on this income. It should follow, without more, that Section 22 (a) subjects respondent to liability.

2. The Treasury Regulations refine the statutory language and make it plain that the income in question is reached by Section 22 (a). Article 166–1 of Regulations 86, *infra*, pp. 32–36, issued under the Revenue Act of 1934, contains an elaborate commentary upon the use of the trust device to reduce surtax liability. It points out that the trust income is to be taxed to the grantor if he is to be regarded as remaining in substance the owner of the property. The general criteria are well stated:

> In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is

or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

These criteria are illustrated, so as to leave no doubt as to their applicability here, as follows:

For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; * * *

Article 166–1 was originally issued under Section 166 alone. But on March 7, 1936, it was amended (T. D. 4629, XV–1 Cum. Bull. 140) to indicate that its authority came from Section 22 (a) as well as Section 166.[2]

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[2] The regulations as amended state:

"(b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. * * *

* * * * * * *

"But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other

Subsequent regulations have left the Article unchanged.[3]

Since the first promulgation of this Article, Congress has three times reenacted, without change, Sections 22 (a) and 166 of the Revenue Act of 1934. Revenue Act of 1936, c. 690, 49 Stat. 1648; Revenue Act of 1938, c. 289, 52 Stat. 447; Internal Revenue Code, 53 Stat. 9, 68. Since the regulation cannot be said to be clearly in conflict with the statute, the repeated reenactment of the statute compels the conclusion that Congress has adopted the administrative construction. *Taft* v. *Commissioner*, 304 U. S. 351, 357; *Hassett* v. *Welch*, 303 U. S. 303, 312; *McFeeley* v. *Commissioner*, 296 U. S. 102, 108; *Morrissey* v. *Commissioner*, 296 U. S. 344, 355.

3. There would, we believe, be no dispute that the respondent would be taxable upon the trust income had the trust been declared for a day-to-day or a month-to-month period.[4] *Du Pont* v. *Commissioner*, 289 U. S.

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trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus."

[3] Article 166-1 of Regulations 94, under the 1936 Act, is identical with the Article as amended in Regulations 86 (see T. D. 4759, 1937-2 Cum. Bull. 117), and Article 166-1 of Regulations 101, under the 1938 Act, retains the same language with two minor transpositions in the order.

[4] Thus, in *Sumner* v. *Commissioner*, 40 B. T. A. 810, the Board of Tax Appeals held that where a taxpayer declares himself trustee for one year to pay the income to his wife, his "control and dominion over the *res* is so substantially the same as it had been while he was unqualified owner as to justify taxing him irrespective of the trust." See, also, *Wollman* v. *Commissioner*,

685, 688–689. On the other hand, the income of a long term irrevocable trust which committed the possession and control of the corpus to an independent trustee would not likely be taxed to the settlor merely because of a reversionary interest. The question here, as in many other tax problems, is simply one of degree. The grantor's liability to tax must depend upon whether he retains so many of the attributes of ownership as to require that he be treated as the owner for tax purposes, or whether he has given up the substance of his dominion and control over the trust property.

Under these circumstances, the question of precisely where the line should be drawn between those irrevocable trusts which deprive the grantor of command over the trust property and those which leave in him the practical equivalent of ownership is, in our view, a matter peculiarly for the judgment of the agency charged with the administration of the tax law. The judgment of the Treasury Department is embodied in Article 166–1 of Regulations 86, quoted above (pp. 10–11). These regulations certainly cannot be said to be so arbitrary as to be clearly in conflict with the statutory provision.

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31 B. T. A. 37; *Rands* v. *Commissioner*, 34 B. T. A. 1107; *Kleinschmidt* v. *Commissioner*, decided by the Board of Tax Appeals on August 19, 1939, unreported memorandum opinion; *Thomson* v. *Commissioner*, decided by the Board of Tax Appeals on December 6, 1938, unreported memorandum opinion, appeal to the Circuit Court of Appeals for the Eighth Circuit pending; *Penn* v. *Commissioner*, decided by the Board of Tax Appeals on April 1, 1939, unreported memorandum opinion, appeal to the Circuit Court of Appeals for the Eighth Circuit pending.

To the contrary, the realistic nature of the regulations is well illustrated by the present record. The transfer made by the taxpayer here did not in any real sense change his economic position. It is a fair assumption that after he had declared himself trustee of the securities, he did not consider himself any poorer than he was before and that his wife did not consider herself any richer. The practical effect of the transaction was not the transfer of property from husband to wife but was, in essence, merely an advance decision by the husband as to the manner in which he desired to apply future income from his property. He did not restrict himself in any way with respect to the sale, exchange, mortgage, pledge, or loan of the corpus of the trust. In the case of a sale he could reinvest the proceeds in any way he chose. He could exercise or appoint proxies to exercise all voting powers with respect to stock in the trust estate. He retained broad powers over even the income of the trust, since, as trustee, he was to pay to his wife at any particular time only such part of the income as he, in his absolute discretion, might determine, the sole restriction being that at the termination of the trust all accrued or undistributed income was to be "deemed and treated" as property of the wife. The wife was to have no title in the principal or income of the trust, neither the principal nor income

[1] Indeed, so much of the income as represented capital gain ($1,160.96 in 1934; R. 11) was to be treated as principal and returned to respondent at the termination of the trust (R. 8). Had we preserved the point, respondent would seem indisputably taxable upon this income under Section 167 (*infra*, p. 31). See *Sawtell* v. *Commissioner*, 82 F. (2d) 221, 223 (C. C. A. 1st).

was to be chargeable for her debts, and she had no power to sell, transfer, encumber, or in any manner anticipate or dispose of any income from the trust property prior to its actual payment or delivery to her.

In other words, the taxpayer was to remain in effect the owner of the property, the only practical change in his status being that, instead of deciding how to use the income from the property as he received it, he decided in advance to give it to his wife. It is evident, we think, that Article 166–1 cannot be said to be arbitrary or in clear conflict with the statute in prescribing that this income must be taxed to the respondent. The Regulation should, therefore, be given effect.

4. The case seems also to be clear on principle. Respondent under the trust deed retained full control of the securities he conveyed to himself as trustee; the fiduciary obligations he assumed were simply to distribute the ordinary income of the securities to his wife (or to hold it as hers). Respondent can escape taxation on the income only if he has acquired immunity because he holds legal title as trustee rather than as an individual, or because he has declared in advance that the income is to be that of his wife. Neither factor, under settled rules, is sufficient to place respondent beyond the reach of the taxing act.

If tax questions were to be determined by technical niceties, it is probable that the Commissioner after plunging into the intricacies of trust conveyancing should solemnly have concluded that respondent as an individual had parted with title to the securities and that they were now owned by respondent as a trustee,

with the consequence that the tax on their income should be paid by respondent as trustee, or his wife as beneficiary, rather than by respondent as an individual. But taxation is not to be controlled by the fictions and *elegantia* of the trust device. It is, as this Court has noted, an "eminently practical" matter. *Tyler* v. *United States*, 281 U. S. 497, 503; *United States* v. *Jacobs*, 306 U. S. 363, 370. The reach of the taxing acts is to be determined by the practical substance of transactions, the location of economic benefits, and by the actual command over the property, rather than by the technical refinements of title. *Lucas* v. *Earl*, 281 U. S. 111, 114–115; *Burnet* v. *Leininger*, 285 U. S. 136, 141–142; *Burnet* v. *Guggenheim*, 288 U. S. 280, 283; *Sanford* v. *Commissioner*, No. 34, this Term; *Griffiths* v. *Commissioner*, No. 49, this Term; *Higgins* v. *Smith*, No. 146, this Term.[6]

Du Pont v. *Commissioner*, 289 U. S. 685, shows that these settled principles have direct application to the short-term trust. In that case the validity of Section 219 (h) of the Revenue Acts of 1924 and 1926, taxing to the settlor trust income used to pay premiums on policies of insurance on the settlor's life, was upheld as applied to a three-year irrevocable trust. The Court stated that the case was governed by *Burnet* v. *Wells*, 289 U. S. 670, decided the same day, in which the same statute had been upheld as applied to an irrev-

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[6] See, also, the decisions on the constitutional scope of the taxing powers of Congress. *Chase Nat. Bank* v. *United States*, 278 U. S. 327, 338; *Corliss* v. *Bowers*, 281 U. S. 376, 378; *Burnet* v. *Wells*, 289 U. S. 670, 678; *Reinecke* v. *Smith*, 289 U. S. 172, 177; cf. *Saltonstall* v. *Saltonstall*, 276 U. S. 260, 271.

ocable trust which was to continue during the grantor's life. The Court, however, added (pp. 688–689):

> * * * *Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate.* During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the income was to hold the principal intact for return to the grantor unless instructed to retain it longer. *The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purpose of taxation he is treated as owner altogether.* [Italics supplied.]

That case, it is true, was concerned only with the constitutional power of Congress. But four Justices, who were of opinion that Section 219 (h) was unconstitutional as applied to the long-term trusts in the *Wells* case, concurred in the *Guggenheim* case because, as stated above, the short-term trusts were insufficient to break the taxpayer's real ownership of the corpus.

The decisions of this Court foreclose any argument that tax liability can be escaped by the assignment of future income. In *Lucas* v. *Earl*, 281 U. S. 111, the Court held income received for personal services taxable although it had been assigned to another. The case, the Court said, was "not to be decided by attenuated subtleties" but in recognition that the section defining gross income was intended to exercise the

power of Congress to "provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised" (pp. 114–115). The Court took this principle one step nearer the facts of the present case in *Burnet* v. *Leininger*, 285 U. S. 136. There the husband was held taxable on his partnership income although he had assigned one-half of his interest to his wife as a partner in that interest; the assignment there related to the income derived from a combination of property and personal services (285 U. S. at 141). It seems plain enough that the decisions are equally applicable to the assignment of income from property alone: "This court has repeatedly said that such an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income." *Reinecke* v. *Smith*, 289 U. S. 172, 177.

It is true, since the *Smith* case just quoted related to constitutionality, that this Court has never squarely held that an assignment of income from property by means of a trust device was ineffective to relieve the assignor of the tax burden. But the Court has applied the doctrine of the *Earl* case in a situation considerably removed from a simple assignment. In *Griffiths* v. *Helvering*, No. 49, this Term, the Court held that the assignment of stock, to be sold at a large profit, to a controlled corporation did not relieve the assignor of taxation upon the profit formally realized by the corporation. It said:

> We cannot too often reiterate that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the

tax is paid." *Corliss* v. *Bowers*, 281 U. S. 376, 378. And it makes no difference that such "command" may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. * * *

The applicability of these principles to the trust device is well illustrated by the decisions of the lower courts, which even before the enactment of the predecessor of Section 166 held that the income of a revocable trust would be taxed to the grantor under the broad definition of gross income found in the revenue acts. *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5th); *Dickey* v. *Burnet*, 56 F. (2d) 917 (C. C. A. 8th), certiorari denied, 287 U. S. 606; *O'Donnell* v. *Commissioner*, 64 F. (2d) 634 (C. C. A. 9th), certiorari denied, 290 U. S. 699; see also *Stoddard* v. *Eaton*, 22 F. (2d) 184, 187 (D. Conn.). There is no difference of substance between a short-term trust and a revocable trust (see *infra*, pp. 24–26); the respondent's powers of control and his substantial ownership of the corpus in this case were, for all practical purposes, as great as those of the grantor of the ordinary revocable trust. The income from the securities held in trust, in either situation, is included within the broad reach of Section 22 (a).

Blair v. *Commissioner*, 300 U. S. 5, upon which respondent places great reliance, does not qualify our position. In that case the taxpayer, who was the life beneficiary of a testamentary trust, assigned certain income interests under the trust to his children, reserv-

ing to himself only the right to a return of those interests should the assignees predecease him. This Court held that he was not taxable on the income paid to his children by the trustees because each assignment was "a complete transfer of the specified interest" (p. 13). The decision, of course, is entirely inapplicable to the present case. The taxpayer there had no command or control over the income-producing properties and he parted with his entire interest in the assigned income except for the possibility of reverter should he outlive the assignees. Here, on the other hand, the taxpayer had extensive rights of possession and control over the trust estate and he was to reacquire absolute ownership of the property after a short period of time. It cannot realistically be said of the taxpayer in the *Blair* case that he retained any of the substantial attributes of ownership; it cannot realistically be said of the taxpayer here that he retained anything less than the substantial equivalent of ownership.[7]

5. It perhaps should be noted explicitly that nothing in the other sections of the Revenue Act of 1934 operate to limit the full sweep of Section 22 (a).

Sections 161, 162, and 163 provide a system for taxing trusts and estates. But these are inapplicable

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[7] *Horst* v. *Commissioner* (C. C. A. 2d), decided November 13, 1939, not yet reported but found in 1939 C. C. H., vol. 4, par. 9766, is opposed to our general argument. The court held a bond holder not taxable on the interest paid on coupons which, before the due date, he had detached and given to his son. The decision seems wrong, and the Government will shortly file a petition for a writ of certiorari.

where the income is properly to be regarded as that of the settlor. Article 166–1 (a), *infra*, p. 32; *Douglas* v. *Willcuts*, 296 U. S. 1, 10.

We urge in the second point of this brief that the respondent is also taxable under Section 166, taxing grantors on the income of revocable trusts. But the fact that Congress has defined with particularity certain instances in which Section 22 (a) applies does not contract the scope of the general definition. *Douglas* v. *Willcuts*, 296 U. S. 1, 10; cf. *Burnet* v. *Guggenheim*, 288 U. S. 280, 288; *Sanford* v. *Commissioner*, No. 34, this Term (pamph. pp. 6–7); *McCauley* v. *Commissioner*, 44 F. (2d) 919 (C. C. A. 5th); *Dickey* v. *Burnet*, 56 F. (2d) 917 (C. C. A. 8th), certiorari denied, 287 U. S. 606; *O'Donnell* v. *Commissioner*, 64 F. (2d) 634 (C. C. A. 9th), certiorari denied, 290 U. S. 699.

6. We submit, therefore, that the declaration of trust did not serve to permit respondent to escape taxation upon the income derived from securities over which he retained full control and to which he would shortly regain even the technical title which he conveyed to himself as trustee.

As this Court has noted, "One can read in the revisions of the revenue acts the record of the Government's endeavor to keep pace with the fertility of invention whereby taxpayers had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens." *Burnet* v. *Wells*, 289 U. S. 670, 675–676. But, the opinion in that case continues, the courts themselves have often blocked escape without insisting upon specific legislative direction, and defeated the expecta-

tion that "The solidarity of the family is to make it possible for the taxpayer to surrender title to another and to keep dominion for himself, or if not technical dominion, at least the substance of enjoyment" (289 U. S. at 677). In consequence, the revenue acts are to be construed to the end that tax liabilities, fairly due from the practical view of command over the economic benefits of the property, cannot be escaped by "a technically elegant arrangement." *Griffiths* v. *Helvering,* No. 49, this Term. See also *Higgins* v. *Smith,* No. 146, this Term; *Foster* v. *United States,* 303 U. S. 118, 120–121; cf. *Sanford* v. *Commissioner,* No. 34, this Term (pamph. p. 6); *Blair* v. *Commissioner,* 300 U. S. 5, 12.

The decision below cannot be squared with this salutary rule of construction. It permits the avoidance of surtaxes by a device which, to the average man, means a mere change of bookkeeping methods rather than a substantive alteration of his financial status. We submit with confidence that Congress could not have intended so to exalt form over substance.

II

THE TRUST INCOME WAS PROPERLY TAXABLE TO THE RESPONDENT UNDER SECTION 166 OF THE REVENUE ACT OF 1934

1. Taxation of the trust income to respondent need not depend upon the fact that respondent was in substance the owner of the trust property and the income was therefore taxable to him under Section 22 (a). That result is also required by the specific provisions

of Section 166, *infra*, p. 30. That section, under the heading "Revocable Trusts," provides:

> Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> (1) in the grantor * * *
>
> * * * * *
>
> then the income of such part of the trust shall be included in computing the net income of the grantor.

The provision first appeared as Section 219 (g) of the Revenue Act of 1924, c. 234, 43 Stat. 253. After reenactment in the 1926 and 1928 Acts, it was modified in the Revenue Act of 1932 (sec. 166, c. 209, 47 Stat. 169) to read as above, except that the provision taxed the income to the grantor "where at any time *during the taxable year* the power to revest in the grantor title to any part of the corpus is vested" in him. The validity of Section 219 (g) was sustained. *Corliss* v. *Bowers*, 281 U. S. 376; *Reinecke* v. *Smith*, 289 U. S. 172. But the lower courts held it inapplicable where the power to revoke required notice more than a year in advance.[8] To escape these decisions,[9] the italicized words were eliminated in the Act of 1934. The problem, therefore, arises only in connection with the section after its amendment in 1934.

[8] *Langley* v. *Commissioner*, 61 F. (2d) 796 (C. C. A. 2d), Judge A. N. Hand dissenting; *Lewis* v. *White*, 56 F. (2d) 390 (D. Mass.), appeal dismissed, 61 F. (2d) 1046 (C. C. A. 1st); *Faber* v. *United States*, 1 F. Supp. 859 (C. Cls.); see *Simpson* v. *Commissioner*, 77 F. (2d) 668, 669 (C. C. A. 7th).

[9] The amendment was made on the floor of the Senate; its purpose is explained by Senator Murphy (78 Cong. Rec. 6471–6472) and in the Conference Report (H. Rep. No. 1385, 73d Cong., 2d Sess., p. 24).

The respondent is clearly within the spirit of Section 166 and can escape its letter only with difficulties too great to surmount in order to contradict the purpose of the Section. Under the terms of the trust deed here involved, title to the trust property was to revest in the grantor at the termination of the trust, either through the expiration of the five-year period or through the earlier death of his wife. If the trust terminated by reason of the grantors' own death prior to the end of the five-year period, title to the trust property was to vest in his estate.

It seems clear that if the grantor had created a trust to continue until the death of himself or his wife, reserving a right to revoke the trust at any time after five years from the date of its creation, the income of the trust would be taxable to him under Section 166. Cf. *Simpson* v. *Commissioner,* 77 F. (2d) 668 (C. C. A. 7th); *Clapp* v. *Heiner,* 51 F. (2d) 224 (C. C. A. 3d); *Kraft* v. *Commissioner,* 40 B. T. A. 240, on appeal to the Circuit Court of Appeals for the Third Circuit. The trust here involved is precisely the same in nature and effect as the trust in the case supposed; the only difference is that in the one case the trust property will be returned to the grantor only if he exercises an option to terminate the trust, whereas in the other case it will be returned to him unless he exercises an option to continue the trust. Clearly Congress could not have intended the provisions of Section 166 to be limited by any distinction so tenuous.

The theory of the court below that Section 166 covers only situations where the grantor retains power to end an otherwise continuing trust estate and does not cover

cases in which the end of the trust after a short period is provided for in the trust indenture itself is, we believe, entirely unrealistic.[10] The rights of the grantor are the same in both situations, and the tax burden attendant upon those rights should therefore also be the same. The argument is that Section 166 relates only

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[10] The same theory underlies the decision in *United States* v. *First Nat. Bank of Birmingham*, 74 F. (2d) 360 (C. C. A. 5th), on the authority of which the Circuit Court of Appeals for the Second Circuit decided *Commissioner* v. *Wood*, 104 F. (2d) 1013, certiorari granted, November 6, 1939, *Helvering* v. *Wood*, No. 384, present Term, to be argued together with this case. The Board of Tax Appeals has also held Section 166 to be inapplicable in *Achelis* v. *Commissioner*, decided by the Board of Tax Appeals on August 31, 1938, unreported memorandum opinion, appeal to the Circuit Court of Appeals for the Second Circuit pending; *Barbour* v. *Commissioner*, 39 B. T. A. 910, appeal to the Circuit Court of Appeals for the Second Circuit pending; *Chamberlain* v. *Commissioner*, decided by the Board of Tax Appeals on March 14, 1939, unreported memorandum opinion, appeal to the Circuit Court of Appeals for the Second Circuit pending; *Goulder* v. *Commissioner*, 39 B. T. A. 670, appeal to the Circuit Court of Appeals for the Sixth Circuit pending; *Hormel* v. *Commissioner*, 39 B. T. A. 244, appeal to the Circuit Court of Appeals for the Eighth Circuit pending; *Ward* v. *Commissioner*, 40 B. T. A. 225, appeal to the Circuit Court of Appeals for the Third Circuit pending; *Central Nat. Bank of Cleveland* v. *Commissioner*, decided by the Board of Tax Appeals on August 3, 1939, unreported memorandum opinion, appeal to the Circuit Court of Appeals for the Sixth Circuit pending; *Woolley* v. *Commissioner*, 39 B. T. A. 802, appeal to the Circuit Court of Appeals for the Second Circuit pending; *Richter* v. *Commissioner*, decided by the Board of Tax Appeals on June 12, 1939, unreported memorandum opinion, appeal to the Circuit Court of Appeals for the Third Circuit pending; *Dunning* v. *Commissioner*, 36 B. T. A. 1222.

But the Board has not considered the question as free from doubt. See, for example, the dissenting opinion in *Hormel* v. *Commissioner*, 39 B. T. A. 244, 250; cf. *Canfield* v. *Commissioner*, 31 B. T. A. 724.

to "revocable trusts" and not to trusts certain to be terminated; that it applies when the grantor has an executory "power" to revest title in himself but not when he has already exercised that power in the trust deed. This is not a sensible intention to attribute to Congress, and revenue acts as other statutes are to be construed sensibly. *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 464. "Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed." *Griffiths* v. *Helvering*, No. 49, this Term.

2. The doubt which may exist as to the correct interpretation of Section 166 is removed by the Regulations. Article 161-1 of Regulations 86, 94, and 101, promulgated under both Sections 22 (a) and 166, plainly includes the short-term trust as well as the revocable trust among the situations where the income is taxable to the grantor (*supra*, pp. 10-11). Section 166 has three times been reenacted, and the administrative construction has thus received the implied approval of Congress (*supra*, p. 12).

3. It is true that when Congress had the Revenue Act of 1934 under consideration, Mr. Roswell Magill, Acting Secretary of the Treasury, made the following recommendation to the House Ways and Means Committee (H. Hearings, Revenue Revision, 1934, 73d Cong., 2d Sess., p. 151):

> The income from short-term trusts and trusts which are revocable by the creator at the expiration of a short period after notice by him, should be made taxable to the creator of the trust.

But the making of this recommendation at most shows that the Treasury Department had doubts concerning whether Section 166 covered short-term trusts, which doubts it later resolved in favor of taxability by the promulgation of Article 166-1 of Regulations 86, quoted above at pp. 10-11. The fact that the Treasury Department recommended legislation specifically covering short-term trusts does not militate against the conclusion that the statute is broad enough to cover such trusts without a specific provision relating to them. Cf. *United States* v. *Lowden*, No. 343, this Term; *Higgins* v. *Smith*, No. 146, this Term. And the fact that Congress failed to adopt the recommendation for a specific provision by no means justifies the conclusion that Congress did not intend to tax to grantors the income from such trusts (*id.*). It may fairly be assumed that after the decision of this Court in May 1933, in *Du Pont* v. *Commissioner*, 289 U. S. 685, Congress deemed any specific reference to short-term trusts unnecessary, for in that case this Court, as pointed out above (pp. 16-17), stated that such trusts do not differ greatly in legal effect from trusts created for a month or from day to day and that, since the grantor of such a trust does not divest himself of title in any permanent or definitive way, he may, for purposes of taxation, properly be treated as the owner of the trust property.[11]

[11] An English statute (12-13 Geo. 5, c. 17, Sec. 20 (1) (*b*) (1922)) provides specifically for taxing to the grantor income of a trust or other disposition pursuant to which the income is payable to another person for a period not in excess of six years and further provides (Sec. 20 (2)) that the grantor may recover the tax paid in such a case from the one to whom the income is

III

TAXATION OF THE TRUST INCOME TO RESPONDENT IS NOT UNCONSTITUTIONAL

It needs no extensive argument to demonstrate the power of Congress to tax the income of a short-term trust to the grantor of the trust. The question was, in effect, decided in *Du Pont* v. *Commissioner*, 289 U. S. 685, where this Court stated with respect to the settlor of a three-year trust that "One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purpose of taxation he is treated as owner altogether" (p. 689). See also *Burnet* v. *Wells*, 289 U. S. 670, 678; *Douglas* v. *Wilcutts*, 296 U. S. 1, 9; *Corliss* v. *Bowers*, 281 U. S. 376, 378; *Reinecke* v. *Smith*, 289 U. S. 172, 177. Since the grantor in this case remained in control of the trust property and was in substance its owner, the case is distinguishable from *Hoeper* v. *Tax Commission*, 284 U. S. 206, "for there the attempt was to tax income arising from property always owned by one other than the taxpayer, who had never had title to or control over either the property or the income from it." *Reinecke* v. *Smith*, *supra*, at 178.

Moreover, the taxation of the trust income to respondent is within the power of Congress to prevent facile escape from the surtaxes which it has prescribed.

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payable. But this special treatment under a comparable statute does not warrant the inference that Congress did not intend to tax trust income to the grantor of a short-term trust under the broad language of Section 166 and Section 22 (a), in the light at least of this Court's statement in the *Du Pont* case.

In *Helvering* v. *City Bank Co.*, 296 U. S. 85, 90, this Court said:

> Congress may adopt a measure reasonably calculated to prevent avoidance of a tax. The test of validity in respect of due process of law is whether the means adopted are appropriate to the end. A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process. * * *

See, also, *Taft* v. *Bowers*, 278 U. S. 470, 482; *Tyler* v. *United States*, 281 U. S. 497, 504–505; *Reinecke* v. *Smith*, *supra*, 178.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

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JANUARY 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

*   *   *   *   *

(U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o) relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question." (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and

gains, profits, and income derived from any source whatever; unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

ART. 166–1 [as amended by T. D. 4629, XV–1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937–2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163, but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend, or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor;

the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such

an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

ART. 167-1 [as amended by T. D. 4759, *supra*, and T. D. 4860, 1938-2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an interest.*—(*a*). *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future

time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust ~~is~~ was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's

legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

U. S. GOVERNMENT PRINTING OFFICE: 1940